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No. 98-799

In The
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1998

KAUTHAR SDN BHD,

Petitioner,

v.

MICHAEL A. STERNBERG, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITIONER'S REPLY BRIEF

DANIEL J. VOELKER
Counsel of Record
WILLIAM N. HOWARD
BRAD S. GRAYSON
JEFFREY S. TOROSIAN
SCHWARTZ & FREEMAN
Attorneys for Petitioner
401 North Michigan Avenue
Suite 1900
Chicago, Illinois 60611
(312) 222-0800

14 pp

QUESTIONS PRESENTED

1. Whether the one-year statute of limitations period for private civil actions for damages under Section 10(b) and Rule 10b-5 as set forth in Section 9(e) of the Securities Exchange Act of 1934 begins to run from the time the victim of the fraud becomes aware that he or she is in fact a victim of fraud (*i.e.*, actual notice) rather than the time the victim becomes aware of facts that would lead a reasonable person to investigate whether he or she might have been a victim of fraud (*i.e.*, inquiry notice).

2. Whether a plaintiff's Section 10(b) and Rule 10b-5 securities fraud claims predicated upon several distinct and unrelated misrepresentations and omissions should be dismissed in their entirety with prejudice as time-barred under the one-year limitations period applicable to such claims when the plaintiff had notice of only one of the several misrepresentations and omissions underlying its claims more than one year prior to the time that it filed suit.

3. Whether this Court should exercise its supervisory powers and remand this case to the circuit court for consideration of the viability of certain state law securities claims because the circuit court rejected one of the grounds upon which the district court based its decision to dismiss those claims, expressly did not consider the other grounds, and nonetheless affirmed the district court's dismissal of those claims without addressing them or providing any basis in its opinion for sustaining their dismissal.

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Petitioner's Reply Brief in Support of its Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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I.

FACED WITH THE DIFFERENT STATUTES OF LIMITATIONS CONTAINED IN THE SECURITIES LAWS, THIS COURT EXPRESSLY CHOSE THE ACTUAL NOTICE STANDARD SET FORTH IN SECTION 9(e) OF THE SECURITIES EXCHANGE ACT OF 1934 TO GOVERN SECURITIES FRAUD CLAIMS BROUGHT UNDER SECTION 10(b) AND RULE 10b-5.

A. The Circuit Courts Have Turned This Court's Decision in *Lampf* on Its Head.

This Court chose Section 9(e) of the Securities Exchange Act of 1934 ("1934 Act") (15 U.S.C. § 78i(e)) as the applicable limitations statute for Section 10(b) and Rule 10b-5 claims. *Lampf, Pleva, Lipkind, Prupis & Petigrow v.*

Gilbertson, 501 U.S. 350, 364, n.9 (1991). The express language of Section 9(e) establishes an actual notice trigger for the running of the limitations period.

Nonetheless, following *Lampf*, federal circuit courts, including the Seventh Circuit, have refused to apply an actual notice standard in determining when the limitations period begins running on Section 10(b) and Rule 10b-5 claims. They have held that the limitations period begins running when the victim of securities fraud is put on inquiry notice of a violation.

The Respondents essentially concede that Section 9(e), on its face, does not contain an inquiry notice standard. However, they try to defend the circuit courts' application of an inquiry notice standard by arguing that Section 9(e) does not contain such a standard because Congress never intended Section 9(e) to govern fraud claims. This argument misses the point.

First, this Court specifically found that Section 9(e) "target[ed] the precise dangers that are the focus of § 10(b)." *Lampf*, 501 U.S. at 360. Moreover, the express language of Section 9(e) establishes an actual notice standard, and this Court adopted that Section's limitations period for Section 10(b) and Rule 10b-5 claims, recognizing that fact.

Indeed, this Court specifically chose the limitation period for Section 9(e) after considering a point made by the Securities and Exchange Commission (the "Commission") in its *Amicus Curiae* brief concerning the differences between that statute's limitations trigger and the trigger found in other securities statutes. The Commission explained:

> Section 9(e) of the 1934 Act provides a period of one year "after discovery of the facts constituting the violation," but no more than three years after "such violation." . . . Section 13 of the 1933 Act, in turn, provides still other variations for each of its express rights of action. In particular, claims under Sections 11 and 12(2)—*unlike claims under Sections 9*, 18, and 29 of the 1934 Act – must be filed within one year of actual or constructive discovery ("after such discovery should have been made by the exercise of reasonable diligence"). . . .

Brief for the Securities and Exchange Commission as *Amicus Curiae*, *Lampf*, 501 U.S. 350 (No. 90-333) (emphasis added; citations omitted). The Commission argued that "these variations can make a critical difference for the timeliness of any particular action . . ." *Id.*

This Court noted the distinctions to which the Commission pointed and expressly selected Section 9(e) as the governing limitations period. *Lampf*, 501 U.S. at 364 n.9 ("The Commission notes, correctly, that the various 1-and-3-year periods contained in the 1934 and 1933 Acts differ slightly in terminology. To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) the 1934 Act, 15 U.S.C. § 78i(e).").

By making this choice, this Court effectively rejected the inquiry notice trigger found in Section 13 of the Securities Act of 1933 ("1933 Act") (15 U.S.C. § 77m). This Court easily could have adopted an inquiry notice standard by stating that the limitations period begins "after such

discovery [of the untrue statement or omission] *should have been made by the exercise of reasonable diligence . . .*" 15 U.S.C. § 77m (emphasis added). However, it adopted the actual notice standard instead. This Court's decision should have been followed by the lower courts but has not been followed.

Legal precedent aside, application of an actual notice standard more strongly promotes the ends of justice. The policy argument set forth in *Tregenza v. Great American Communications Co.*, 12 F.3d 717 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994), to support an inquiry notice trigger, which the Respondents quote to support their position, protects the wrong party—the tortfeasor—at the expense of the fraud victim. In *Tregenza*, the Seventh Circuit espoused a view that the limitations period set forth in *Lampf* creates a "heads I win, tails you lose" situation for a victim of securities fraud because a victim theoretically could wait up to three years to see which way the market for his investment goes before filing suit. *Tregenza*, 12 F.3d at 722. While this may be true, neither the court in *Tregenza* nor the Respondents explain why the law should favor tortfeasors on this limitations issue rather than fraud victims. There is, after all, a three-year repose period to eliminate any threat that the victim will not act diligently to prosecute his or her claim.

The circuit courts and the Respondents seek to impose what is effectively a one-year repose period rather than the three-year repose period set forth in Section 9(e). In the Seventh Circuit, for example, the limitations period begins to run when the victim becomes aware of facts that would lead a reasonable person to investigate whether he or she might have a claim. *Tregenza*, 12 F.3d at 718, 721-22. In calculating this period, the Seventh Circuit applies its rule

that a "reasonable investor is presumed to have information available in the public domain . . ." *Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 610 (7th Cir. 1995). The net effect of this rule is to impute to the victim knowledge of all of the information available on the Internet and the World Wide Web, information on file with the Commission and all other governmental agencies, information contained in annual reports rarely received by investors and even more rarely read, and all other public information. The limitations period then begins to run when a reasonable person, who is unfairly presumed to possess this obscure and hard to find information, would have conducted a further investigation into the facts and thereafter learned of the fraudulent conduct.

As pointed out in the *Amici Curiae* brief of the American Association of Retired Persons and the Consumer Federation of America, this sort of sophistication, not to mention expertise in navigating the information superhighway, is simply too much to expect of the average investor. Yet, according to the rule being applied by many of the circuits, if the slightest evidence of abnormal investment performance exists somewhere in the deep recesses of the Internet or World Wide Web, then the one-year limitations period is triggered for all fraud claims related to that investment. In such a circumstance the victim more than likely would not even know of the fraud until well after the one-year limitations period has expired.

This cannot be the result intended by this Court when it decided *Lampf*. Victims of securities fraud must be given a fair shot at the courthouse to redress their claims. Justice is not served by protecting tortfeasors from actions filed by victims within one year of learning that they were defrauded.

B. This Court Should Address the Statute of Limitations Issue Raised in the Petition.

The Petitioner contested the dismissal of its Rule 10b-5 claims on statute of limitations grounds throughout the proceedings below. Moreover, the Petitioner specifically cited this Court's decision in *Lampf* in its briefs in the circuit court in arguing that its claims were not time-barred.

While the Petitioner did not specifically address below the distinction between actual and inquiry notice, that question is of significant enough importance to warrant this Court's review of the issue in this case. This is particularly so in light of the circuit courts' consistent failure to follow this Court's decision on that issue in the *Lampf* case.

The circuit court's application of an inquiry notice standard to determine when the statute of limitations began to run on the Petitioner's Rule 10b-5 claims constituted the kind of fundamental error that justifies this Court's review of a question not pressed below. *Sibbach v. Wilson & Co., Inc.*, 312 U.S. 1, 16 (1941). Moreover, the consistent misapplication of the law by the circuit courts on this issue and the interests of justice warrant consideration of the issue by this Court on this Petition. *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1099 n.8 (1991) (an issue not considered below should be considered where it is "'"in a state of evolving definition and uncertainty,"' . . . and [is] one of importance to the administration of federal law.").

II.

FRAUD CLAIMS BASED UPON SEVERAL DISTINCT AND UNRELATED MISREPRESENTATIONS AND OMISSIONS SHOULD NOT BE DISMISSED IN THEIR ENTIRETY AS TIME-BARRED MERELY BECAUSE THE LIMITATIONS PERIOD MAY HAVE EXPIRED ON ONE ASPECT OF THOSE FRAUD CLAIMS.

This Court should examine whether fraud claims based upon several distinct and unrelated misrepresentations and omissions should be dismissed in their entirety as time-barred merely because a claim based upon one of those misrepresentations and omissions may have been time-barred. The Petitioner's securities fraud claims in this case arose from several separate and distinct misrepresentations and omissions made by the Respondents on several separate and distinct subjects. The district court in this case, however, chose to lump together all of those separate and distinct bases for the Petitioner's claim in determining that all aspects of all of the Petitioner's claims should be dismissed merely because the Petitioner was on inquiry notice of the falsity of one representation made by the Respondent more than a year prior to the time that it filed suit.

The district court justified its decision in this case by concluding at the pleading stage that the one misrepresentation of which the court concluded the Petitioner had inquiry notice more than a year prior to filing suit was a "critical component of [the Respondents] fraud." The circuit court accepted this aspect of the district court's decision in affirming the dismissal on appeal. However, the lower courts' analyses of this issue are flawed

Even if the Petitioner was on notice of the potential falsity of one representation made by the Respondents, the clock should not have started running on claims arising from completely unrelated misrepresentations and omissions of which the Petitioner had no notice of any potential falsity. The claims arising from misrepresentations and omissions of which the Petitioner was not on inquiry or actual notice should not have been dismissed as time-barred.

Considering the relatively short limitations period for bringing federal securities fraud claims—one year—the approach taken by the district court and circuit court in this case will lead to unreasonably harsh results, particularly if an inquiry notice trigger is applied. Under the approach taken by the courts in this case, victims of fraud would be forced to uncover all aspects of a fraudulent scheme, no matter how divergent and unrelated, and then prepare and file suit, all within a year.

This Court should intervene to protect victims of fraud from the effect of these unreasonably draconian rules. The interests of justice demand it.

III.

THE VIABILITY OF THE PETITIONER'S STATE LAW SECURITIES FRAUD CLAIMS SHOULD BE REVIEWED.

The Respondents completely mischaracterize the record with respect to the Petitioner's state law securities fraud claims. Contrary to what the Respondents say, the Petitioner specifically did ask the circuit court to reverse the district court's dismissal of those claims and did argue the viability of those claims on appeal. In addition, contrary to

what the Respondents say, the Petitioner has not contended that the circuit court should have decided to allow those claims to go to trial, although the Petitioner obviously would like to be able to bring its claims to trial. Tellingly, the Respondents fail to cite or reference anything in the record to support their assertions concerning the Petitioner's state law securities fraud claims.

The Petitioner seeks this Court's intervention because the appellate court failed to even consider the viability of the Petitioner's state law securities fraud claims in affirming the dismissal of those claims. The circuit court expressly rejected one of the bases for the district court's dismissal of those claims and it expressly did not consider the other grounds relied upon by the district court for dismissal. It appears as if the circuit court simply overlooked or ignored the Petitioner's state law securities fraud claims.

If the Respondent is suggesting that the Petitioner should have argued for different treatment of its state law securities fraud claims than its federal law securities fraud claims on the statute of limitations issue on which the circuit court affirmed dismissal of the Petitioner's federal law securities fraud claims, that argument makes no sense. The Petitioner's state law securities fraud claims were filed well within the three-year limitations period for such claims and no party or court ever has suggested otherwise. Therefore, there was no reason for the Petitioner to argue for separate treatment on that issue below.

This Court should intervene in this case to ensure that the Petitioner's state law securities fraud claims are properly considered by the circuit court before dismissal of those claims is affirmed. That never has been done. Ac-

cordingly, remand to the circuit court for consideration of the viability of those claims is appropriate.

CONCLUSION

This Court should grant the Petition so that it may disavow the practice of applying an inquiry notice standard to private civil actions brought under Section 10(b) and Rule 10b-5. Such a holding would require the reversal of the decision of the Seventh Circuit because the Petitioner filed this case within one year of being on actual notice of the Respondents' fraud. This Court also should grant the Petition to evaluate whether notice of one aspect of a fraud claim triggers the running of the limitations period for a claim based upon unrelated misrepresentations and omissions. Finally, this Court should grant the Petition so that it may remand this case for proper consideration by the circuit court of the plaintiff's Indiana state law securities fraud claims.

Respectfully submitted,

DANIEL J. VOELKER
Counsel of Record

WILLIAM N. HOWARD
BRAD S. GRAYSON
JEFFREY S. TOROSIAN
SCHWARTZ & FREEMAN
401 North Michigan Avenue
Chicago, Illinois 60611
(312) 222-0800
Counsel for Petitioner